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C O N F I D E N T I A L SECTION 01 OF 02 MUSCAT 001136

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STATE FOR NEA/ARP, EEB/IFD/OMA
TREASURY FOR OTA VALVO

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TAGS: EFIN ECON PREL MU
SUBJECT: OMAN REMAINS COMMITTED TO DOLLAR

REF: MUSCAT 1101

Classified By: Ambassador Gary A. Grappo, reasons 1.4 b and d

Summary

¶1. (C) The Central Bank Executive President affirmed to the Ambassador that Oman would maintain its currency peg to the dollar and the current rate of exchange, although he also asked for the USG's support in stabilizing the greenback. He acknowledged that inflationary pressures were calling into question the peg, but dismissed such concerns in light of demand considerations for food, building materials, and labor. The Executive President also reiterated Oman's decision not to join the GCC currency union, but added that the Sultanate would participate in the GCC customs union and common market. End Summary.

Peg to Remain

¶2. (C) On December 17, the Ambassador reviewed the status of Oman's currency peg with Oman Central Bank Executive President Hamood Sangour al-Zadjali. Zadjali reiterated statements made to the Ambassador by Minister of National Economy (and supervisor of the Ministry of Finance) Ahmed bin Abdul Nabi Macki (reftel) that continuing with the dollar peg was in Oman's best interests, given that most of the Sultanate's reserves were in dollars and that the dollar is accepted virtually everywhere. He agreed with the Ambassador's view that recent public discussion by other GCC officials on dropping the peg had caused unnecessary instability in the currency markets, which led to speculation that Oman would de-couple the rial from the greenback. To counter speculative actions on the rial, Zadjali stated that the government has made numerous public statements in support of the peg.

Need for Strong Dollar

¶3. (C) Zadjali relayed his concern, however, over the weakening dollar. "There's lots of public pressure here regarding the declining rial. With inflation rising, there are so many questions as to why we are sticking with the dollar." He added that those complaining don't understand the technical merits of retaining the peg at the current value, and that he had full confidence that the USG remained interested in keeping the dollar strong in spite of the advantages a cheaper currency has in terms of trade balances. He further received backing from an IMF Article IV

evaluation team on staying the course with the dollar peg at the current value. Nevertheless, the Executive President urged the USG to support the dollar. "Our reserves are in dollars, and we'd like to keep them in dollars."

Not All Inflation is Imported

¶4. (C) Commenting on recent inflationary pressures in Oman, Zadjali stated that too much emphasis was being placed on imported inflation. While conceding that the dollar's weakness was a factor, other variables, such as strong demand and relatively strained supply, were playing a more significant role. "It's a structural thing, but the layman doesn't understand." The IMF team cautioned the Bank that increased government spending was also contributing to inflationary pressures, especially since the crush of infrastructure projects was pressuring cement, steel, and labor costs. Zadjali readily acknowledged this point, but explained that it was "a good time" to use accumulating surpluses to build ports, airports, telecommunications infrastructure, and industrial zones. "We have to meet the needs of the people," stated Zadjali, adding that in the wake of spending hikes by its GCC neighbors, Oman felt compelled to keep up in terms of modernizing its infrastructure.

Labor Costs a Concern

¶5. (C) In addition to the increasing costs of food and construction materials, Zadjali emphasized the rising price tag of labor as a concern. He stated that the region would

soon be facing significantly higher labor costs as a result of salary pressures in the home markets of expatriate workers. For example, the Executive President commented that salaries for federal workers in the UAE would increase by 70%, which would put pressure on expatriate wages throughout the Gulf. By virtue of Oman's common border with the UAE, Zadjali fully expected wage hikes to trickle into the Sultanate, not to mention the effect of higher salaries for workers in Saudi Arabia and Qatar.

No Currency Union in Sight

¶6. (C) Zadjali noted to the Ambassador that the GCC continued to move forward with the proposed currency union, though policy makers understand that the 2010 deadline to achieve such a milestone was unfeasible. He reiterated Oman's position not to join the union, stating, "We are outside for good. This is our final stand." While commenting that the currency union was not as important to the GCC as it was to the EU, the Executive President affirmed Oman's interest in joining the GCC customs union and common market.
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